

A photograph of a forest floor covered in lush green ferns, with several tree trunks visible in the background. The lighting is dappled, suggesting sunlight filtering through the canopy.

TREE TALK

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Mississippi's Reforestation Tax Credit: What You Need To Know

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Mississippi House Bill 1628 of the 2007 Regular Session, as signed by the governor in March 2007, has increased the lifetime limit of the Mississippi Reforestation Tax Credit (RTC) to \$75,000. This will allow landowners to avoid paying up to \$75,000 in Mississippi income tax with qualifying site preparation and reforestation expenses of \$150,000. RTC makes an already profitable investment in commercial timber much more attractive to landowners by significantly reducing initial investment costs.

Mississippi is considered a "piggy-back" state for income tax, which means that federal deductions generally transfer to the state tax form. Prior to the passage of the Mississippi RTC, a forest landowner would transfer federal reforestation deductions to his or her Mississippi tax form. In 1999, the Mississippi RTC was implemented. By using the Mississippi RTC, a Mississippi taxpayer who reforested Mississippi land was allowed to claim a 50 percent tax credit against approved costs. The maximum amount of tax credit that could be taken during his or her lifetime was \$10,000 per taxpayer. The credit was claimed against the lesser of actual cost or average cost as established by the Mississippi Forestry Commission.

Under the new rules, the lifetime limit is increased to \$75,000, with a maximum of \$10,000 RTC each year. If the Mississippi RTC exceeds taxes owed for the year, the unused portion can be carried forward and used against subsequent years' taxes. After \$75,000 of RTC is taken, landowners can resume the piggyback process of claiming the same deduction on federal and state tax returns.

The RTC can be used by private individuals, groups and associations, including trust property and estates. It cannot be used by corporations that manufacture products or their subsidiaries, or by public utilities or their subsidiaries. Some landowners will not be able to fully utilize the RTC, if their only income is pension income. Mississippi does not tax pension income, so there would be little or no tax to be offset by the credit. Landowners in this situation should apply for cost-share funding from the state or federal government if assistance is needed to cover reforestation costs.

A written reforestation prescription prepared by a graduate forester of a Society of American Foresters-accredited institution or by a forester registered under the Mississippi Foresters Registration Law of 1977 is required for the use of the Mississippi RTC. The plan must include a legal description and map of the affected area, list of species used in reforestation and a written description of site preparation or reforestation practices prescribed. The forester signs the Reforestation



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Tax Credit Form 80-315 to certify that the plan was followed and the work was completed. Form 80-315 has an accompanying worksheet to determine allowable costs for application of the tax credit. Upper limits for costs are based each year on average cost-share rates for typical reforestation practices. Once allowable costs are determined, they are compared with actual costs. The lesser of allowable and actual costs are multiplied by 50 percent to determine the tax credit. A copy of the worksheet must be mailed to the Mississippi Forestry Commission so that use of the Mississippi RTC can be tracked.

Mississippi RTC use is limited when cost-share is used for reforestation work. Only if the landowner's adjusted gross income is below the federal earned income credit level can the Mississippi RTC be applied against the out-of-pocket costs of cost-shared practices. Otherwise, the taxpayer must choose between cost-share and the use of the Mississippi RTC.

Special rules for the Mississippi RTC apply to married taxpayers. If married couples own individual tracts with respective qualifying reforestation expenses, each can claim up to the lifetime limit of \$75,000. If their property is jointly owned, the upper limit is applied to the couple. This is similar to the limit that applies to partnerships and other group ownerships. The limit is applied at the partnership level as well as the individual level. For example, Bob, Bill, and John are brothers who own 640 acres of timberland together. Their reforestation expense in 2007 totals \$200,000 in approved costs, with each brother paying \$66,667. The RTC limit on this property is \$75,000, and each can take a tax credit of \$25,000. Because only \$10,000 in RTC can be claimed each year, each brother will have a \$10,000 credit for 2007 taxes, \$10,000 in 2008, and the final \$5,000 in 2009. Each brother still has up to \$50,000 RTC available if he has reforestation expenses on other tracts, owned individually or with another group ownership.

While the Mississippi RTC is an enticing incentive for reforestation, it does not negate the use of the federal tax recovery provisions. The American Jobs Creation Act of 2004 contains major provisions for deducting reforestation expenses from federal income taxes. Reforestation expenses for site preparation, seeding, planting or other practices necessary to ensure survival of a viable commercial timber stand are recovered under rules developed from this legislation. Landowners cannot deduct the value of their own labor unless they pay themselves a salary which is treated as income.

Each year, up to \$10,000 in reforestation expenses for each qualified timber property can be deducted. For property in the Gulf Opportunity Zone, the \$10,000 deduction limit was increased to

\$20,000 for expenses incurred before January 1, 2008 except for corporations, REITS or entities with more than 500 acres of qualified timber property. Any expense over the initial deduction is amortized and deducted over 84 months using the following formula:

Year 1: 1/14 of amortizable basis (a half-year's amortization)

Years 2-7: 1/7 of amortizable basis

Year 8: 1/14 of amortizable basis (a half-year's amortization)

Trusts are ineligible for the initial deduction; however, all costs can be amortized using the same formula.

To use these special provisions, an election is required. The election is made by filing Part IV of Form T, Forest Activities Schedule or by attaching an election statement containing the account, block, tract, area or stand identification number for each qualified timber property, type of activity, number of acres treated, and total expenditures. The election statement should refer to Internal Revenue Code Section 194(b) that covers these deductions.

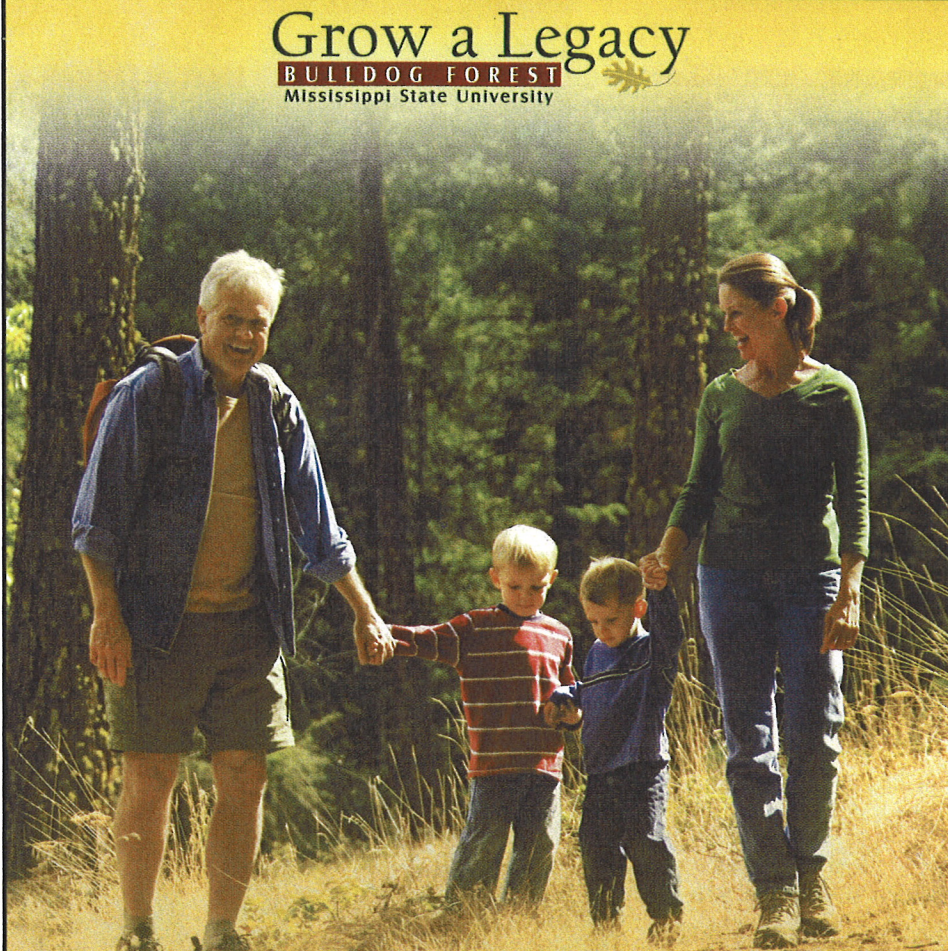
Instead of the deduction and amortization, a taxpayer can add reforestation expenses to the appropriate timber basis account. The recovery will then be postponed until the timber is sold or lost. At the time of timber sale, the appropriate basis (timber depletion) is subtracted from gross proceeds, along with the sales expenses, to determine net taxable gain. If timber suffers a casualty or other business loss, the deductible loss is limited to the loss in fair market value or basis, whichever is less.

Federal deductions are never taken as miscellaneous itemized deductions. The amortization deductions are first taken on Part VI of Form 4562, Depreciation and Amortization. For investors, deductions are then reported on the front of Form 1040 as an adjustment to income on line 36 (a subtotal line for adjusted gross income) for the 2006 version of Form 1040. For business owners, deductions are reported on Schedule F, Profit or Loss from Farming of Form 1040. Business owners will report deductions on Schedule C, Profit or Loss from Business of Form 1040 or the appropriate business form. All federal forms and instructions can be downloaded from the IRS website, www.irs.gov or obtained by ordering them from the IRS Hotline at (800) 829-3676.

For more details on use of federal and Mississippi reforestation recovery rules, please contact your county MSU Extension Service Office for a free copy of MSU-ES Publication 2420, Paying for a New Forest without Cost-Share Funding. This publication can also be downloaded from www.msucare.com. MSU Forest and Wildlife Resources Center Publication No: FO336

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